Supreme Court, U.S.
FILED

961135 JAN 2 1997

No. OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1996

CITY OF DETROIT PENSION FUND and CITY OF DETROIT POLICE and FIREMAN PENSION FUND,

Petitioners,

vs.

PRUDENTIAL SECURITIES, INC.,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Do the District Courts have jurisdiction to interpret and determine the applicability of the National Association of Securities Dealers Code of Arbitration Procedures, which interpretation shall be final and binding upon the parties, in particular Section 15 of the National Association of Securities Dealers Code of Arbitration Procedure, prior to an arbitration hearing?

II. Do the rules of the National Association of Securities Dealers Code of Arbitration Procedure grant subject matter jurisdiction to the Federal Courts pursuant to 28 U.S.C. § 1332?

III. Does interpretation of Section 15 of the National Association of Securities Dealers Code of Arbitration Procedure grant Diversity Jurisdiction to the Federal Courts pursuant to 28 U.S.C. § 1331?

LIST OF PARTIES

The names of all parties to the proceedings in the court whose judgment is sought to be reviewed here appear in the caption of the case. Prudential Securities, Inc. is a wholly owned subsidiary of the Prudential Insurance Company.

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Appendix C — Judgment of the United States District Court for the Eastern District of Michigan, Southern Division Dated January 3, 1995 ..... 5a

Petitioners, City of Detroit Pension Fund and City of Detroit Police and Fireman Pension Fund, respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit.

OPINIONS BELOW

The opinion of the Court of Court of Appeals is reported at 91 F.3d 26 and is reproduced in the Supplemental Appendix. The unreported opinion of the District Court in this case is also reproduced in the Supplemental Appendix.

STATEMENT OF JURISDICTION

The Court of Appeals entered its judgment on July 31, 1996 and denied the Petition for Rehearing En Banc on October 3, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The pertinent provision of the Federal Arbitration Act, 9 U.S.C. § 2, and Sections of Title 28, Judiciary and Judicial Procedure, 28 U.S.C.A. § 1331 and 8 U.S.C.A. § 1332 are set forth below:

> United States Code Annotated
> Title 9. Arbitration
> Chapter 1— General Provisions
>
> *9 U.S.C. § 2.* Validity, Irrevocability And Enforcement Of Agreements To Arbitrate
>
> A written provision in any maritime transaction or a contract evidencing a

transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

United States Code Annotated
Title 9. Arbitration
Chapter 1 — General Provisions

9 U.S.C. § 4 A party aggrieved by the alleged failure , neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States District court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement.

28 U.S.C.A. § 1331

Title 28. Judiciary And Judicial Procedure
Part IV — Jurisdiction And Venue
Chapter 85 — District Courts; Jurisdiction

§ 1331. Federal question

The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States.

28 U.S.C.A. § 1332

Title 28. Judiciary And Judicial Procedure
Part Iv--jurisdiction And Venue
Chapter 85 — District Courts; Jurisdiction

§ 1332. Diversity Of citizenship; amount in controversy; costs

(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $50,000, exclusive of interest and costs, and is between —

(1) citizens of different States;

(2) citizens of a State and citizens or subjects of a foreign state;

(3) citizens of different States and in which citizens or subjects of a foreign state are additional parties; and (4) a foreign state, defined in section 1603(a) of this title, as plaintiff and citizens of a State or of different States.

For the purposes of this section, section 1335,

and section 1441, an alien admitted to the United States for permanent residence shall be deemed a citizen of the State in which such alien is domiciled.

(b) Except when express provision therefor is otherwise made in a statute of the United States, where the plaintiff who files the case originally in the Federal courts is finally adjudged to be entitled to recover less than the sum or value of $50,000, computed without regard to any setoff or counterclaim to which the defendant may be adjudged to be entitled, and exclusive of interest and costs, the district court may deny costs to the plaintiff and, in addition, may impose costs on the plaintiff.

(c) For the purposes of this section and section 1441 of this title —

(1) a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business, except that in any direct action against the insurer of a policy or contract of liability insurance, whether incorporated or unincorporated, to which action the insured is not joined as a party-defendant, such insurer shall be deemed a citizen of the State of which the insured is a citizen, as

STATEMENT OF THE CASE

The original claim for arbitration was filed with the National Association of Securities Dealers (NASD) on or about February 2, 1994. The claim was served on the Respondent Prudential Securities Inc. (PSI) by the NASD on or about March 8, 1994. The claim alleged violation of various rules of the NASD, violation of fiduciary duty, violation of the Michigan Uniform Securities Act, the 1933 Securities Act and the 1934 Securities Exchange Act. The Claim for Arbitration demanded arbitration of the claims in accordance with the NASD Code of Arbitration Procedure. At the time the Claim for Arbitration was filed, Respondent Prudential Securities Inc. (PSI) was a member of the NASD. Section 1 of the NASD Code of Arbitration requires its members to arbitrate any disputes with clients The documents signed by Petitioners when they opened their account with PSI, also contained a clause which required the Defendant PSI to arbitrate any disputes between the parties. Without discussion with the attorney for Petitioners, the NASD unilaterally granted Respondents an extension of time to answer the Claim for Arbitration. Finally on April 26, 1994, Respondent PSI informed the NASD that Respondent was not going to answer the Claim, but institute litigation which is a violation section 6 of the NASD Code of Arbitration. The NASD did nothing to enforce the contract of arbitration. Respondent failed to answer the Claim for Arbitration. The NASD refused to schedule the hearing based upon letters which Defendant PSI sent to the NASD stating they were not going to answer the Demand for Arbitration. The Petitioners requested the NASD to enter the default of Respondent PSI. When the NASD refused to either schedule the arbitration or enter a default, the Funds then filed a Petition for Entry of Default with the District Court, which Respondent answered and filed its Counter Petition for Declaratory Judgement which Declaratory Judgment, the District Court granted.

The decision of the District Court was based upon Section 15 of NASD Code of Procedure, which sets the time limits for the eligibility of the submission of claims to arbitration. The District Court failed to address the duties of the Director of Arbitration for the NASD in determining eligibility of claims, specifically, Section 1 which states that the Code governs any dispute and Section 35 which states that it is for the arbitrators to interpret the NASD Arbitration Code of Procedures. The granting of the Petition for Declaratory Judgement by the District Court was based strictly on the District Court's interpretation of Section 15 of the NASD Code of Arbitration Procedure. The District Court failed to address the language of Section 35 of the NASD Code of Arbitration, which states that it is for the arbitrators to interpret the NASD Code of Procedure. Had the Court ordered the matter to arbitration, then Prudential Securities could have moved to vacate any decision pursuant to 9 U.S.C. § 10.

On appeal, the United States District Court of Appeals for the Sixth Circuit upheld the decision of the District Court. While it appears from the decision that the Sixth Circuit agrees that 28 U.S.C. § 1331 does not grant subject matter jurisdiction, the Circuit Court without discussion decided that the District Court had jurisdiction pursuant to 28 U.S.C. § 1332. Neither the District Court nor the Sixth Circuit correctly addressed the 28 U.S.C. § 1332. The Counter\complaint and Motion for Declaratory Judgment did not meet the jurisdictional amount in controversy. The courts looked at the collateral value of the of the Claim for Arbitration, which this Court has said it cannot do.

Additionally, the Circuit Court did not address Section 35 of the NASD Code of Arbitration Procedure, which states that it is for the arbitrators to interpret the Code. This Court must tell all of the District Courts and Circuit Court to let the arbitrators do their job, and only hear Petitions to Vacate pursuant to 9 U.S.C. § 10.

REASONS FOR GRANTING THE WRIT

The Court should grant the writ in order to resolve a five to five split between the federal circuit courts to determine who has the jurisdiction to interpret the eligibility of claims for arbitration pursuant to Section 15 of the National Association of Securities Dealers Code of Arbitration Procedure. Five of the circuits have ruled that it is for the arbitrators to decide, and five of the circuits have ruled that it is for the courts to decide.

Without a "definite rule" the outcome of claims for arbitration filed with the National Association of Securities Dealers, pursuant to its Code of Arbitration Procedure will be determined by the circuit in which the investor lives, not the merits of the claim. Additionally, by having the Courts determine eligibility questions, the federal courts are still in the securities fraud business, which was supposed to end with this Court's decision of *Shearson/American Express, Inc. v. McMahon,* 107 S. Ct. 2332 (1987).

Some of the Circuits, such as the Sixth, allow for a tolling of the eligibility requirements of Section 15 of the Code if fraudulent concealment has been pled with specificity. This puts the courts in the position of determining how much concealment is enough to toll the eligibility requirements. This should be decided by the arbitrators after they have heard all of the evidence.

Finally, by telling the courts to stay out of the arbitration procedure, until after the decision of the arbitrators, the court will finally enforce the arbitration contract that the securities industry prayed for when it had the decision in *Wilko v. Swan* overturned by this Court in *Shearson/American Express, Inc. v. McMahon,* 107 S. Ct. 2332(1987).

I.

DO THE DISTRICT COURTS HAVE JURISDICTION TO INTERPRET AND DETERMINE THE APPLICABILITY OF ALL PROVISIONS OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS CODE OF ARBITRATION PROCEDURES WHICH INTERPRETATION SHALL BE FINAL AND BINDING UPON THE PARTIES, IN PARTICULAR SECTION 15 OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS CODE OF ARBITRATION PROCEDURE PRIOR TO AN ARBITRATION HEARING?

THE NASD ARBITRATION CODE OF PROCEDURE

Prudential Securities Inc. (PSI) is a member of the National Association of Securities Dealers (NASD), and as a member is subject to the *NASD Code Of Arbitration Procedure.* Members of the NASD are required, at the demand of the nonmember client, arbitrate any disputes between them. Among the key provisions of the NASD Code of Arbitration which are pertinent to this appeal are sections 1, 6, 12, 15, 16, 21 and 35 which expressly provide as follows:

LEGAL PROCEEDINGS

> Sec.6. *No* party shall, during the arbitration of any matter prosecute or commence any suit, action or proceeding against any other party touching upon any of the matters referred to arbitration pursuant to this Code.

REQUIRED SUBMISSION

> Sec. 12. (a) *Any* dispute, claim or

controversy eligible for arbitration under Part I of this Code between a customer and a member and/or associated person arising in connection with the business of such member or in connection with the activities of such associated persons *shall be arbitrated under this Code,* as provided by any duly executed and enforceable written agreement or upon the demand of the customer.

ELIGIBILITY

Sec. 15. No dispute, claim, or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim, or controversy. This section shall not extend applicable statutes of limitation, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.

DISMISSAL OF PROCEEDINGS

Sec. 16. At any time during the course of an arbitration, the arbitrators may, either upon their own initiative or at the request of a party, dismiss the proceeding and refer the parties to the remedies provided by applicable law. The arbitrators shall at the joint request of all the parties dismiss the proceedings.

Sec. 21(b)(1) Within twenty (20)

> business days from receipt of the Statement of Claim, the Respondent(s) shall serve each party with an executed Submission Agreement and a copy of the Respondent's Answer. . . . The Answer shall specify all available defenses and relevant facts thereto that will be relied upon at the hearing. . . .
>
> INTERPRETATION OF CODE
>
> Sec. 35. The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code which interpretation shall be final and binding upon the parties.

The Plaintiff\Appellee Prudential Securities Incorporated (PSI) claimed in paragraph 17 of the original Answer, Additional Defenses and Counterclaim: "Prudential Securities at no time agreed to arbitrate the Pension Funds claims." This is a fraudulent statement. Defendant PSI was bound to arbitrate the claims of customers pursuant to the National Association of Securities Dealers Code of Arbitration Procedure section One(l), since PSI is a member firm of the NASD. The Plaintiff\Appellee PSI then proceeded to base the Counterclaim and Motion for Declaratory Judgement on Section 15 of the Code of Procedure. PSI refused to acknowledge the existence of Section 35 of the Code. Thus, PSI is bound by the Code of Procedure to submit the issue of eligibility to the arbitrators.

The Supreme Court in *Shearson/American Express, Inc. v. McMahon,* 107 S. Ct. 2332 (1987) ruled that disputes arising under Rule 10b-5 of the Securities Exchange Act were subject to agreements to arbitrate.

The Supreme Court in *Rodriguez de Ouijas v. Shearson/ American Express, Inc.*, 109 S. Ct. 1917 (1989) held that agreements to submit to arbitration, disputes arising under the Securities Act, are enforceable under the Federal Arbitration Act.

9 U.S.C. § 4 of the Federal Arbitration Act states in pertinent part: "A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States District court which. save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement."

The Claim for Arbitration as originally submitted in this matter is arbitral pursuant to the NASD Constitution. Prudential Securities, Inc. by refusing to file an answer to the Claim for Arbitration and filing the Counterclaim and Motion for Declaratory Judgement sought to achieve one of two goals.

The first goal was to void the arbitration contract.

The second goal was to have the Court selectively interpret one section of the contract of arbitration in a manner which would deprive the investor of any forum for redress of the fraud committed by Prudential Securities, Inc., one of the largest frauds ever committed on the investing public.

The first step in deciding this issues presented in this writ, is to analyze the pertinent parts of the arbitration contract. Prudential Securities provided the District Court with only selected excerpts of the contract of arbitration, the NASD Code of Arbitration Procedure. Prudential Securities in paragraph 5 of the Motion to Enjoin states that eligibility for arbitration is

for the courts and not the NASD to decide, and cites several cases. The Sixth Circuit held the duty to arbitrate is a contractual one. *Wiepking v. Prudential Bache Securities, Inc.*, 940 F. 2d 996, 998 (6th Cir. 1991). ("The starting point in arbitration disputes is to determine whether the parties agree to arbitrate <the> dispute.") (quoting, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985)). A party cannot be compelled to arbitrate claims that fall outside their agreement to arbitrate. As the Supreme Court recognized in *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643 (1986):

> . . . arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to so submit . . . This axiom recognizes the fact that arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration.

The Supreme Court in *Litton Financial Printing Division v. NLRB*, 111 S. Ct. 2215, 2226 (1991) stated: "Whether or not a (party) . . . is bound to arbitrate, as well as what issues it must arbitrate, is a matter to be determined by the court, and a party cannot be forced to arbitrate the arbitrability issue."

AT&T Technologies put it best by stating plainly that whether a contract creates a duty to arbitrate a particular grievance is an issue for the courts to decide.

The contract of arbitration between the parties in the instant complaint was entered into when the Appellant/Defendants (Funds) opened their investment account with Prudential Securities. The new account agreement was drafted by the

Prudential Securities. The Code of Arbitration was drafted by the National Association of Securities Dealers, Inc. of which Prudential Securities is one of the owner/members, and thus a drafter of the Code. *Mastrobouno v. Shearson Lehman Hutton,* page 18, 1995 U.S. Lexis 1820 Decided March 6, 1995.

Section one (1) of the Code of Arbitration procedure states:

> This Code of Arbitration procedure is prescribed and adopted pursuant to Article VII, Section(a)(3) of the Bylaws of the National Association of Securities Dealers, Inc., (Association) for the arbitration of *any* dispute, claim or controversy arising out of or in connection with the business of any member of the Association, with the exception of disputes involving the insurance business of any member which is also an insurance company."

(Emphasis added).

Therefore the broad language encompasses any dispute involving the sale of securities. The NASD adopted the Code of Procedure which is the contract under which the parties are to arbitrate their disputes involving the sale of securities. An example of what would be excluded, are such claims for personal injury, or any dispute which does not involve the sale of securities. Current decisions, however, have held that even sexual harassment claims in the securities industry are subject to the NASD Code of Arbitration.

The above language encompasses any dispute. This necessarily includes any dispute as to the eligibility of any claim. It is hornbook law that ambiguities in a contract are held against

the drafter. *Mastrobouno v. Shearson Lehman Hutton,* page 18, 1995 U.S. Lexis 1820 Decided March 6, 1995, *Brauer v. Hobbs,* 151 Mich. App. 769, (1986).

Prudential Securities by the Motion attempted to unilaterally exempt itself from the very contract it imposes on investors. *Wiepking v. Prudential-Bache Secs., Inc.,* 940 F.2d 996 (CA 6 1991). This Circuit went on to say that the contract of arbitration simply requires Courts to enforce privately negotiated agreements to arbitrate, like other contracts in accordance with their terms. Section 35 of the Code of Arbitration states that it is for the Arbitrators to interpret the Code of Procedure, not the Courts. The filing of the Motion to Enjoin is a violation of Section 6 of the NASD Code of Arbitration Procedure, yet the National Association of Securities Dealers has done nothing to enforce the Code. *Simon v. Smith Barney, Harris Upham & Co.,* (1988-1989 Transfer Binder) Fed. Sec. Law. Rep. (CCH) Para 94,178 at 91631 (W.D. Okla. Jan 11, 1989) (citations omitted).

Prudential Securities postured the Motion to Enjoin upon an interpretation of Section 15 of the NASD Code of Procedure that cannot stand close judicial scrutiny.

The securities industry got its wish when the Supreme Court overturned the *Wilko v. Swan* decision and ordered the enforcement of arbitration agreements. *Shearson/American Express, Inc. v. McMahon,* 107 S. Ct. 2332 (1987). Now the securities industry is trying to destroy the Code of Arbitration one section at a time, as exemplified by the brief of Prudential which focuses solely on the issue of Section 15, and not the whole contract. While the Sixth Circuit has adopted the position that it for the Courts to decide eligibility of Section 15 claims, it appears that none of the Circuits that hold to this position have addressed the issue against the requirements of Section 35.

Respondent cited with approval the *Roney v. Kassab decision of the Sixth Circuit. Roney v. Kassab,* 981 F.2d 894 (6th Cir. 1992) *Roney* was based on the assumption that Section 15 of the NASD Code of Procedure was applied in the same way as Rule 603 of the New York Stock Exchange Rules of Procedure. The *Roney* decision does not address the differences between the two sections, and it does not discuss Section 15 in conjunction with Section 35. The "occurrence or event" in Section 15 of the NASD Code of Procedure does not commence the running of eligibility requirement on the date of the purchase of the security. It is the position of the NASD, that the "occurrence or event" which gives rise to the event is to be determined on a case by case basis.

The only way to determine the "occurrence or event" which gave rise to the complaint or whether there was fraudulent concealment sufficient to extend the eligibility requirements, is for the arbitrators to hear all of the evidence. *PaineWebber, Inc. v. Landy,* 903 F. Supp 193 (U.S.D.C. Ma. 1995).

The *Roney* decision can be easily distinguished. Rule 603 of the New York Stock Exchange begins to run on the date of the transaction. *Roney v. Kassab, Id.* Additionally, the facts in the Roney case show that the broker had left the Roney firm more than six years prior to the filing of the Claim for Arbitration, which is also the same fact pattern in *PaineWebber v. Hartmann,* (21 F.2d 507 (3rd Cir. 1990) and *PaineWebber, Inc. v. Farnam,* 870 F.2d 507 (7th Cir. 1989) In the instant case, the stockbroker was still with PSI at the time the claim for arbitration was filed. Neither the *Hartmann* nor the *Farnam* decision discuss the role of the Director of Arbitration in making the initial determination of eligibility. A close reading of the *Roney* opinion indicates that it is for the Director of Arbitration to makes the initial determination of the eligibility of claims for arbitration.

PSI, in the instant case, failed to comply with the NASD Code of Procedure when it failed to respond to the Claim for Arbitration, which would have allowed the Director of Arbitration to make the initial determination as to the eligibility of arbitration of the Claim for Arbitration filed by the Petitioners.

PSI should not be allowed to disregard the common-law rule of contract interpretation that a court construe ambiguous language against the interest of the party that drafted it. *United States v. Seckinger,* 387 U.S. 203 (1970). Defendants drafted the document, the NASD Code of Procedure. *Mastrobouno v. Shearson Lehman Hutton,* page 18, 1995 U.S. Lexis 1820 Decided March 6, 1995. On page 20, the Court delivers the Coup de Gras to the position of PSI. The Court said, "Finally the respondents' reading of the clauses violates another cardinal principle of contract construction: that a document should be read to give effect to all its provisions and to render them consistent with each other." (cites omitted).

Thus this Court should read Section 15 in conjunction with Section 35 and the procedures which are set forth in the NASD Code of Procedure, and issue an opinion which leaves no doubt that the arbitrators are to interpret the NASD Code of Arbitration Procedure and reverse the decision of the Circuit Court and the District Court. The aggrieved party will still be able to file a Petition to Vacate pursuant to 9 U.S.C. § 10.

II.

DO THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS CODE OF ARBITRATION PROCEDURE GRANT SUBJECT MATTER JURISDICTION TO THE FEDERAL COURTS PURSUANT TO 28 U.S.C. § 1331?

Prudential filed the Counter/complaint and Motion for Declaratory Judgement in reliance on Section 15 of the NASD Code of Arbitration Procedure which states:

> Sec. 15. No dispute, claim, or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim, or controversy. This section shall not extend applicable statutes of limitation, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.

The case law very clearly says there is no private right of action for violation of an exchange or NASD rule. *Miller v E.W. Smith Co.*, 581 F. Supp. 817 (E.D. Pa. 1983) *c.f. Kirkland v. E.F. Hutton & Co.*, 564 F. Supp 427 (E.D. Mich. 1983) *Jaksich v. Thomson McKinnon Securities, Inc.*, 582 F. Supp. 485 (S.D.N.Y. 1984); *Watling Lerchen & Co. v. Ormand,* 86 Mich. App. 238 (1978).

In a case exactly on point, in which Prudential Securities sought the same relief based on Section 15 of the NASD Code of Arbitration Procedure, as it seeks in this case, it was held that the rules of the NASD Code of Procedure, and in particular

Section 15 of the NASD Code of Arbitration Procedure do not grant the Court jurisdiction to enjoin the arbitration. *In re Prudential Sec., Inc.*, 795 F. Supp 657, 659 (S.D.N.Y. 1992).

Therefore, the District Court did not have subject matter jurisdiction to decide the issues raised by Prudential Securities in the Counter/Complaint and Motion for Preliminary Injunction, and it did not have jurisdiction to issue an order barring the arbitration.

The NASD is a private corporation, and the NASD rules are established and enforced by a private association and do not give rise to federal question jurisdiction. *In re Prudential Sec., Inc.*, 795 F. Supp 657, 659 (S.D.N.Y. 1992). *Ford v. Hamilton Investments, Inc.*, 29 F.3d 255 (6th Cir. 1994).

The Sixth Circuit Court of Appeals in regards to the Court deciding eligibility issues in a case confirming a National Association of Securities Dealers arbitration award had previously stated:

> Federal courts may hear cases under the Arbitration Act only where some independent basis for federal jurisdiction exists, and the dispositive question presented here — a question that we have raised sue sponte — is whether the district court had jurisdiction over the subject matter of the instant case.

Ford v. Hamilton Investments, 29 F.3d 255 (CA 6 1994). The court went on to say:

> Subject matter jurisdiction cannot be conferred on federal courts by consent of the parties.

Commodity Futures Trading Common v. Schor, 478 U.S. 833 (1986) It is well established that Sec. 4 of the Federal Arbitration Act, 9 U.S.C. § 4, does not constitute a grant of subject matter jurisdiction.

The court in *Ford* went on to state:

> Merely referring to a federal statute, however, does not establish federal jurisdiction if the dispute does not involve a substantial question of federal law.

As stated above, the case law clearly holds that the Code of Arbitration Procedure does not involve a federal statute. The Code of Arbitration Procedure is set of rules issued by a private corporation, not a federal act. *Lange v. H. Hentz & Co,* 418 F. Supp. 1376 (ND Tex. 1976). The rules of the NASD can be changed at any time by submitting the change to the Securities and Exchange Commission. The latest recommendation of the NASD is that Section 15 of the NASD Code be eliminated.

If as stated in the *Ford* decision, there is no federal common law of contracts, and the parties are in arbitration pursuant to a contract of arbitration, the District Court had no jurisdiction to issue an order in this matter, and the District Court order must be dismissed.

In the Matter of the Application of Prudential Securities Incorporated and Prudential-Bache Properties, Inc., 795 F. Supp. 657 (S.D.N.Y. 1992), Prudential Securities moved, which motion was granted, a remand on the grounds that the federal courts lack subject matter jurisdiction over the National Association of Securities Dealers Rules of Arbitration Procedure. Therefore, this Court must overrule the Circuit Court and the District Court and order this dispute to arbitration by clearly

stating once and for all that it is for the arbitrators to interpret the NASD Code of Arbitration Procedure.

III.

DOES INTERPRETATION OF SECTION 15 OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS CODE OF ARBITRATION PROCEDURE GRANT DIVERSITY JURISDICTION TO THE FEDERAL COURTS PURSUANT TO 28 U.S.C. § 1332?

The basis for jurisdiction in the Counter-complaint and Motion for Declaratory Judgment pled by Prudential Securities was diversity of citizenship. Prudential based the allegation of diversity jurisdiction in the Counter/Complaint on 28 U.S.C. § 1332 and 28 U.S.C. § 2201. P rudential only sought declaratory relief in the Counter/complaint, as there is no allegation of monetary damages in excess of $50,000, which is required before the Court can assume jurisdiction under 28 U.S.C. § 1332 (b). Therefore, PSI did not plead the minimum dollar amount necessary to grant the Court jurisdiction. Thus 28 U.S.C. § 1332 did not provide a basis for jurisdiction.

It is assumed for purposes of this argument, that diversity of citizenship exists, as required by 28 U.S.C. § 1332, in that this dispute is between citizens of different states. Even granting Prudential that assumption, 28 U.S.C. § 1332 does not grant the Federal Courts jurisdiction to grant an injunction to stop an arbitration of a duly authorized dispute. The second requirement of 28 U.S.C. § 1332 in order for the Federal courts to exercise diversity jurisdiction over all civil actions is that the amount in controversy exceed $50,000(recently changed to $75,000).

The Counter\complaint filed by Prudential demanded an injunction, based upon an interpretation of the National

Association of Securities Dealers Code of Arbitration Procedure. This does not embody a federal cause of action, a cause of action involving a substantial federal question, an amount in controversy over $50,000 and no other independent basis for subject matter jurisdiction exists, thus the injunction must be dismissed.

In the instant case, the amount in controversy cannot exceed $50,000. In determining the amount in controversy in a given action, the collateral effect of the judgment or other matters not directly involved in the pending suit cannot be taken in consideration. *Washington & G.R. Co. v. District of Columbia,* 146 U.S. 227, 36 L. Ed. 951, 13 S. Ct. 64; *New England Mortg. Sec. Co. v. Gay,* 145 U.S. 123, 36 L. Ed. 646, 12 S. Ct. 815. If from the nature of the case as stated in the pleadings there could not legally be a judgment in excess of the jurisdictional amount, jurisdiction cannot attach even though the damages claimed in the complaint seek a sum in excess of the jurisdictional amount. *Washington & G.R. Co. v. District of Columbia,* 146 U.S. 227, 36 L. Ed. 951, 13 S. Ct. 64; *New England Mortg. Sec. Co. v. Gay,* 145 U.S. 123, 36 L. Ed. 646, 12 S. Ct. 815. The issue for the District Court to decide on the Motion for Declaratory judgment was only the interpretation of Section 15, this did not exceed the jurisdiction amount as required. The interpretation of Section 15 of the NASD Code of Arbitration does not amount to a judgment in excess of $50,000. The fact that ultimately the arbitrators might grant an award in excess of $50,000 does satisfy the jurisdictional amount as this is clearly a collateral event. Even if the Court accepts the argument that there is diversity of citizenship, there is still no private right of action for an alleged preemptory breach of the NASD Code of Arbitration Procedure. *Gafford v. General Elec. Co* , 997 F.2d 150 (6th Cir. 1993).

In a case analogous in many ways to the instant case, *Dones v. Eastern Air Lines,* 408 F. Supp. 1044 (1975 D.C. PR) the

court examined the issue of whether diversity of citizenship grants jurisdiction if the court lacks subject matter jurisdiction. The court quoted from *Pennsylvania Railroad Co. v. Day,* 360 U.S. 548 (1959) a case in which jurisdiction was based on diversity of citizenship and which the Supreme Court remanded to the District Court with instructions to dismiss for lack of jurisdiction, the disputes between the employers and employees subject to the Railway Labor Act, Title 45 United State Code Section 151 *et seq.*, must be settled by the administrative boards therein established since these boards have exclusive primary jurisdiction over said disputes.

While the Dones case was decided in relation to airline administrative boards, there is little doubt in the instant case, that the NASD arbitration panels have primary jurisdiction to decide disputes between investors and brokerage firms through the arbitration process.

9 U.S.C. § 2 states:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

In the instant case, Sec. 35 of the NASD Code of Arbitration Procedure states:

> The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code which interpretation shall be final and binding upon the parties.

Section 35 leaves no doubt that it is for the arbitrators to interpret the Code, not the Courts. In fact, once the Claim for Arbitration is filed, the parties are barred from resorting to the Courts.

> Sec.6. *No* party shall, during the arbitration of any matter prosecute or commence any suit, action or proceeding against any other party touching upon any of the matters referred to arbitration pursuant to this Code.

Ultimately the court in *Pennsylvania Railroad* said, "Consequently the Court is of the opinion that under the terms of the Railway Labor Act, it lacks jurisdiction over the subject matter and cannot entertain the action even though diversity jurisdiction has been invoked and conceded." The same should be said of the Federal Arbitration Act and the NASD Code of Arbitration Procedure.

Therefore, the injunction must be dissolved and the parties ordered to arbitration.

28 U.S.C. § 2201 does not provide for an independent basis of jurisdiction, it only provides a remedy.

Thus, the District Court had no jurisdiction to entertain the Counter/Complaint and Motion of Plaintiff/Appellee and this Court should rule once and for all that it is for the arbitrators to hear all of the evidence and decide the issues.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT FILED OCTOBER 4, 1996

No. 95-1078

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

CITY OF DETROIT PENSION FUND, ET AL.,

Plaintiffs-Appellants,

v.

PRUDENTIAL SECURITIES, INCORPORATED,

Defendant-Appellee.

ORDER

BEFORE: NORRIS and SUHRHEINRICH, Circuit Judges; and WELLS,* District Judge.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

---

* Hon. Lesley Brooks Wells, United States District Judge for the Northern District of Ohio, sitting by designation.

Appendix A

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER THE COURT

s/ Leonard Green
Leonard Green, Clerk

APPENDIX B — JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT FILED JULY 31, 1996

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 95-1078

CITY OF DETROIT PENSION FUND; CITY OF DETROIT POLICE AND FIREMAN PENSION FUND,

Plaintiffs-Appellants,

v.

PRUDENTIAL SECURITIES, INCORPORATED,

Defendant-Appellee.

Before: **Norris** and **Suhrheinrich,** Circuit Judges; **Wells,** District Judge.

JUDGMENT

ON APPEAL from the United States District Court for the Eastern District of Michigan at Detroit.

THIS CAUSE was heard on the record from the district court and was argued by counsel.

IN CONSIDERATION WHEREOF, it is ORDERED that the judgment of the district court is AFFIRMED.

Appendix B

ENTERED BY ORDER THE COURT

s/ Leonard Green
Leonard Green, Clerk

A True Copy.

Attest:

Deputy Clerk

APPENDIX C — JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MICHIGAN, SOUTHERN DIVISION DATED JANUARY 3, 1995

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Civil Action
No. 94-CV-71767-DT

HON. BERNARD A. FRIEDMAN

CITY OF DETROIT PENSION FUND; et al.,

Plaintiffs,

v.

PRUDENTIAL SECURITIES, INC.,

Defendant.

JUDGMENT

The court has granted Defendant's motion to enjoin and dismiss arbitration claim and to dismiss petition for confirmation of award. Accordingly,

IT IS ORDERED AND ADJUDGED that judgment be and is hereby granted for Defendant and against Plaintiffs.

Dated at Detroit, Michigan, JAN 3, 1995.

Appendix C

JOHN P. MAYER
CLERK OF THE COURT

By s/ J.N. Bardsai
Deputy Clerk

Approved:

s/ Bernard A. Friedman
BERNARD A. FRIEDMAN
UNITED STATES DISTRICT JUDGE

Supreme Court, U.S.
FILED
FEB 16 1997
CLERK

No. 96-1135

In The

Supreme Court of the United States

October Term, 1996

CITY OF DETROIT PENSION FUND and CITY OF DETROIT POLICE and FIREMAN PENSION FUND,

Petitioners,

vs.

PRUDENTIAL SECURITIES INCORPORATED,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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COUNTER STATEMENT OF QUESTIONS PRESENTED

1. Whether the district court had jurisdiction to dismiss the Pension Funds' petition to confirm arbitration award and grant PSI's motion to enjoin and dismiss arbitration claim?

2. Whether the ineligibility of the Pension Funds' arbitration claim presented a threshold arbitrability issue appropriate for judicial resolution?

LIST OF THE PARTIES

Petitioners are the City of Detroit Pension Fund and City of Detroit Police and Fireman Pension Fund.

Respondent is Prudential Securities Incorporated. a wholly owned subsidiary of the Prudential Insurance Company of America.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit is reported at 91 F.3d 26 (6th Cir. 1996) and is reproduced in the Supplemental Appendix for Petitioners, Appendix A at pp. 1sa-8sa. Denial of the petition for rehearing and suggestion for rehearing *en banc* is reported at 1996 U.S. APP. LEXIS 27505 (6th Cir. Oct. 4, 1996).

The opinion and order of the United States District Court for the Eastern District of Michigan is unreported, but is reproduced in the Supplemental Appendix for Petitioners, Appendix B at pp. 9sa-18sa.

STATEMENT OF JURISDICTION

Jurisdiction is premised upon 28 U.S.C. § 1254(1). The United States Court of Appeals for the Sixth Circuit entered judgment on July 31, 1996 affirming the judgment of the district court. The court of appeals thereafter denied the Pension Funds' petition for rehearing and suggestion for rehearing *en banc* on October 3, 1996.

COUNTER STATEMENT OF THE CASE

In accordance with Supreme Court Rule 15.2, a Counter Statement of the case is necessary because the petition for a writ of certiorari recites as "fact" assertions which are untrue, not part of the record and were not decided below.

Petitioners, the City of Detroit Pension Fund and City of Detroit Police and Fireman Pension Fund ("Petitioners" or the "Funds"), maintained investment accounts at Respondent, Prudential Securities Incorporated ("Respondent" or "PSI"), a securities brokerage firm. Disappointed with the performance

of investments made in 1985 and 1986, the Funds brought an arbitration claim against PSI before the National Association of Securities Dealers, Inc. ("NASD") on February 2, 1994. (DCR[1] 2, Ex. 1).

The Funds' arbitration claim was accompanied by an NASD Uniform Submission Agreement. Through the Uniform Submission Agreement, the Funds agreed to arbitrate their claims "in accordance with the Constitution, By-Laws, Rules, Regulations and/or Code of Arbitration Procedure" of the NASD. (DCR 2, Ex.1). Section 15 of the NASD's Code of Arbitration Procedure (the "Code") erects an absolute jurisdictional barrier to stale arbitration claims:[2]

> No dispute, claim, or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim, or controversy. This section shall not extend applicable statutes of limitations, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.

The Funds' 1994 arbitration claim was filed 8-9 years after the disputed 1985-86 investments. The Funds' claim was, therefore, ineligible for arbitration pursuant to § 15 of the Code.

---

1. DCR refers to the district court record.

2. During 1996, the NASD renumbered the provisions of its Code of Arbitration Procedure. Former § 15 of the Code is now referred to as NASD Rule 10304. A substantial body of law interpreting and applying § 15, however, has developed over the years. Practitioners and courts, alike, continue to refer to the NASD's eligibility rule as "§ 15." As a result, for simplicity, this brief shall continue to refer to the NASD's eligibility rule as § 15.

PSI timely notified the NASD and opposing counsel that it objected to the NASD's exercise of jurisdiction, and that it intended to file a federal district court petition to enjoin and dismiss the arbitration. (DCR 3, Exs. 1 and 2). The NASD acknowledged PSI's response, and assured counsel that it would refrain from the further administration of the Funds' claim pending the district court's resolution of PSI's request for injunctive relief. (DCR 3, Ex. 3).

Despite (1) PSI's timely response to the Funds' NASD claim; (2) PSI's vehement objection to the NASD's jurisdiction; (3) the NASD's recognition of PSI's response; (4) the NASD's assurance that it would refrain from the further administration of the Funds' claim pending a determination of the district court petition; and (5) the absence of an NASD rule authorizing the entry of a party's default in arbitration, the Funds' counsel nevertheless requested that the NASD enter the default of PSI. (DCR 6, Ex. 8). The NASD ignored the Funds' request for entry of PSI's default; the Code does not authorize entry of either a party's default or a default arbitration award.

Undaunted, on May 5, 1994 the Funds filed a petition in the United States District Court for the Eastern District of Michigan to confirm the "phantom" default arbitration award purportedly entered by the NASD. (DCR 1). The civil cover sheet accompanying the petition asserts federal question jurisdiction as well as diversity of citizenship. (DCR 1; *See also* civil cover sheet served upon PSI, attached as Exhibit "2" to PSI's March 15, 1996 Supplemental Brief to the Sixth Circuit). In their petition to confirm, the Funds request judgment against PSI in the amount specified in the arbitration claim ($11,351,928.62). (DCR 1).

On June 3, 1994 PSI filed its answer, additional defenses and a counterclaim in the district court against the Funds. (DCR

3). PSI requested dismissal of the Funds' arbitration claim because it was untimely and ineligible for arbitration pursuant to § 15 of the Code. (DCR 3).[3] PSI also filed a motion to enjoin and dismiss the Funds' arbitration claim, as well as to dismiss the Funds' petition for confirmation of the "phantom" default arbitration award. (DCR 2). PSI's counterclaim alleged the existence of both diversity and federal question jurisdiction. (DCR 3, ¶ 7). In light of the Funds' (1) filing of their own district court petition; and (2) assertion of both federal question and diversity jurisdiction, jurisdiction was not in contest before the district court.

The district court heard oral argument on PSI's motion on December 1, 1994. On December 19, 1994 the district court issued a bench ruling granting both (1) PSI's motion to dismiss the Funds' petition to confirm arbitration award; and (2) PSI's motion to enjoin and dismiss the arbitration claim. (DCR 22).

The Funds maintained that their arbitration claim was timely. The Funds alleged (albeit in vague and conclusory

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3. In their petition for a writ of certiorari (pp. 5, 12-13), the Funds assert that they signed PSI account opening documents containing an arbitration clause which *contractually* obligated the parties to arbitrate before the NASD. This assertion is not supported by the record. Instead, the duty to arbitrate derives from § 12 of the Code, which obligates NASD registrants and member firms, such as PSI, to arbitrate any dispute brought by a public customer, such as the Funds. Regardless of the source of the duty to arbitrate, PSI is obligated to arbitrate only eligible claims. PSI is not obligated to arbitrate stale claims, which are ineligible for submission to the NASD pursuant to § 15 of the Code.

The Funds unprofessionally accuse counsel of "fraudulently" stating that PSI "at no time agreed to arbitrate" the Funds' claims. (*See* petition for a writ of certiorari, p. 10.) Since (1) PSI's duty to arbitrate derives from the Code, and not a private pre-dispute arbitration agreement between the parties; and (2) PSI remains unwilling to arbitrate only ineligible claims, the Funds' charge rings hollow.

fashion) that PSI fraudulently concealed its wrongdoing, thereby tolling the claim filing deadline. The district court deferred ruling on the Funds' fraudulent concealment argument, allowing the parties the opportunity to provide additional evidence to the court on that specific issue. (DCR 22).

Subsequently, on December 23, 1994 the district court issued its written opinion and order. The court rejected the Funds' claim that PSI fraudulently concealed any alleged wrongdoing.[4] (DCR 23, pp. 6-10). The district court entered judgment in favor of PSI and against the Funds on January 4, 1995. (DCR 24). The Funds filed their notice of appeal on January 18, 1995, contesting both the dismissal of their petition to confirm as well as the dismissal of their NASD arbitration claim. (DCR 25).

On July 31, 1996 the Sixth Circuit affirmed the judgment of the district court. The appellate court concluded that (1) the requirements of diversity jurisdiction under 28 U.S.C. § 1332 had been met;[5] (2) it was for the district court, and not the

---

4. At the time the district and appellate courts ruled in this matter, the Sixth Circuit had not resolved whether § 15 was an absolute jurisdictional threshold akin to a statute of repose, and not subject to tolling, or whether it effectively operated as a statute of limitations subject to tolling. The Sixth Circuit has since, however, conclusively determined that eligibility provisions (such as § 15 and the corresponding New York Stock Exchange, Inc. ("NYSE") rule (Rule 603)) are absolute, impermeable jurisdictional thresholds which are *not* subject to tolling. *The Ohio Company v. Nemecek*, 98 F.3d 234 (6th Cir. 1996).

The Funds are obviously incorrect in stating that the Sixth Circuit will "allow for a tolling of the eligibility requirements of § 15 of the Code if fraudulent concealment has been pled with specificity." (*See* petition for a writ of certiorari, p. 7). This assertion is clearly contrary to the Sixth Circuit's holding in *Nemecek*.

5. Neither the district court nor the Sixth Circuit addressed whether an independent basis of federal question jurisdiction existed. The existence of diversity jurisdiction obviates the necessity of this Court's consideration of the Funds' federal question concerns.

arbitrators, to resolve the threshold arbitrability issue under § 15; and (3) the court need not resolve whether § 15 is subject to tolling on the basis of fraudulent concealment because the Funds did not adequately plead fraudulent concealment before the district court.

On August 14, 1996 the Funds filed a petition for rehearing and suggestion for rehearing *en banc*. On October 3, 1996 the Sixth Circuit denied the petition, and the Funds' petition for a writ of certiorari to this Court followed.

REASONS FOR DENYING THE WRIT

The Funds invoked the jurisdiction of the district court but now seek to deny the court's jurisdiction to escape an adverse ruling. Nonetheless, the Sixth Circuit correctly decided that the district court had diversity jurisdiction over this dispute.The court found the parties are citizens of different states and, because the Funds seek in excess of $11 million from PSI, the amount in controversy exceeds the jurisdictional requisite of $50,000.

Moreover, the Sixth Circuit's decision does not present an important question for review, as required by Supreme Court Rule 10(a). The court below reaffirmed and applied Supreme Court precedent that courts (and not arbitrators) have the authority to determine the arbitrability of disputes.

I.

THE DISTRICT COURT HAD DIVERSITY JURISDICTION TO DISMISS THE FUNDS' PETITION FOR CONFIRMATION OF ARBITRATION AWARD AND GRANT PSI'S MOTION TO ENJOIN AND DISMISS ARBITRATION CLAIM.

During the relevant time frame, 28 U.S.C. § 1332 provided in pertinent part that:

> (a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $50,000, exclusive of interest and costs, and is between —
>
> (1) citizens of different States . . .
>
> * * *
>
> (c) For the purposes of this section and section 1441 of this title —
>
> (1) a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business . . .

28 U.S.C. §§ 1332 (a) and (c).

A. The Sixth Circuit's Conclusion.

The Sixth Circuit found diversity jurisdiction to exist:

> Because the parties are of diverse citizenship and the requisite minimum amount is in controversy, the district court had jurisdiction under 28 U.S.C. § 1332.

(*See* Supplemental Appendix for Petitioners ("PSA"), Appendix A at p. 6sa).

The court found that by the Funds' own admission, the requisites to diversity jurisdiction had been met. Also, it reasoned that it would be fundamentally unfair to allow the Funds to escape an adverse ruling by subsequently denying jurisdiction since:

> (1) the Funds admitted at oral argument that the parties are citizens of diverse states and the amount in controversy "greatly exceeds" $50,000; and
>
> (2) the Funds initially invoked the jurisdiction of the district court, lost on the merits, and then tried to avoid the preclusive effects of the district court's judgment by challenging jurisdiction on appeal.

(*Id.* at 5sa-6sa.)

B. The Parties Are Citizens Of Different States.

The present controversy is between citizens of different states. The Funds were established, maintain their principal place of business and operate in Detroit, Michigan. PSI is a Delaware corporation with its principal place of business in New York.

The Funds initiated district court proceedings by submitting

a petition to confirm arbitration award. A civil cover sheet signed by counsel asserts the parties' diversity. (DCR 1).

PSI timely answered the Funds' petition and filed a counterclaim. (DCR 3). PSI's counterclaim unmistakably asserts that the district court has jurisdiction under 28 U.S.C. § 1332 by virtue of the parties' diverse citizenship. (DCR 3, ¶¶ 5-7). The Funds admitted that this element of diversity jurisdiction existed in their reply to counterclaim (DCR 6, ¶¶ 5-6), as well as in oral argument before the Sixth Circuit.

It is beyond serious dispute that the parties are citizens of diverse states; the only remaining inquiry is whether the amount in controversy exceeds the sum or value of $50,000, exclusive of interest and costs. Similarly, there can be no serious dispute on this question.

C. The Amount In Controversy Exceeds $50,000.

The Funds' arbitration claim requests total damages of $11,351,928.62, broken down as follows:

> (a) $6,319,964.20 for loss of investment principal,
>
> (b) $4,000,000.00 in interest, and
>
> (c) $1,031,964.42 in attorney fees.

The *ad damnum* of the Funds' district court petition requests judgment "in the amount specified in the Claim for Arbitration" ($11,351,928.62).

The Funds, relying upon two factually distinguishable late

19th Century decisions, now apparently contend that the amount in controversy requirement has not been met. This argument is frivolous. This Court, in an early decision, *St. Paul Mercury Indemnity Co. v. Red Cab Co.*, 303 U.S. 283, 288, 58 S. Ct. 586, 82 L. Ed. 845 (1938), articulated the general principle that the amount claimed by the plaintiff generally controls:

> The rule governing dismissal for want of jurisdiction in cases brought in the federal court is that, unless the law gives a different rule, the sum claimed by the plaintiff controls if the claim is apparently made in good faith.

More recently, this Court, in *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333, 346-47, 97 S. Ct. 2434, 53 L. Ed. 2d 383 (1977), declared that:

> In actions seeking declaratory or injunctive relief, it is well established that the amount in controversy is measured by the value of the object of the litigation.

Hatridge v. Aetna Casualty & Surety Co., 415 F.2d 809, 815 (8th Cir. 1969), offers this common sense test for determining the amount in controversy:

> The test for determining the amount in controversy is the pecuniary result to either party which the judgment would directly produce . . . it is the amount or value of that which the complainant claims to recover, or the sum value of that which the defendant will lose if the complainant succeeds in his suit . . .

See also Leininger v. Leininger, 705 F.2d 727, 729 (5th Cir. 1983) ("[T]he amount in controversy, in an action for declaratory or injunctive relief, is the value of the right to be protected or the extent of the injury to be prevented."); and *Hatridge*, citing with approval a leading scholar, Professor Charles Wright: "[T]he purpose of a jurisdictional amount, to keep trivial cases away from the court, is satisfied where the case is worth a large sum to either party." C. Wright, *Federal Courts* § 34, at p. 100 (1963).

Here, the value of the object of this litigation is $11,351,928.62. This is the sum claimed by the Funds in their district court petition. PSI asked the district court to enjoin and dismiss a claim presenting a risk of a potential loss in this amount. It is frivolous for the Funds to suggest that the amount in controversy is other than as claimed in their *ad damnum*. The amount in controversy is not trivial; it well exceeds the $50,000 minimum imposed by 28 U.S.C. § 1332(a); and the district court correctly concluded diversity jurisdiction existed.

II.

INELIGIBILITY OF THE FUNDS' ARBITRATION CLAIM PRESENTED A THRESHOLD ARBITRABILITY ISSUE APPROPRIATE FOR JUDICIAL RESOLUTION.

The Sixth Circuit succinctly summarized the Funds' key contention:

> The focus of the Funds' argument in their brief is that the district court should not have decided whether the claims against PSI were eligible for arbitration. Instead, the Funds argue, the district court should have ordered PSI to submit the arbitrability issue to an arbitration panel.

A. Courts (And Not Arbitrators) Decide Whether A Dispute Is Arbitrable, As Well As What Issues Must Be Arbitrated.

The Funds maintain that NASD arbitrators should decide the eligibility issue. This contention flies in the face of Supreme Court precedent. This Court has clearly empowered courts, and not arbitrators, with the authority to determine the scope of arbitration agreements:

> [T]he question of arbitrability — whether a collective-bargaining agreement creates a duty for the parties to arbitrate the particular grievance — is undeniably an issue for judicial determination. Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agree to arbitrate is to be decided by the court, not the arbitrator.

AT&T Technologies, Inc. v. Communications Workers, 475 U.S. 643, 649, 89 L. Ed. 2d 648, 106 S. Ct. 1415 (1986).

AT&T was quoted with approval by the Supreme Court five years later in *Litton Financial Printing Division v. NLRB*, 501 U.S. 190, 198, 115 L. Ed. 2d 177, 111 S. Ct. 2215 (1991). In *Litton*, the Supreme Court stated:

> [W]hether or not a [party] . . . is bound to arbitrate, as well as what issues it must arbitrate, is a matter to be determined by the court, and a party cannot be forced to arbitrate the arbitrability issue.

The Sixth Circuit has adopted *AT&T* and *Litton* in *Roney and Co. v. Kassab*, 981 F.2d 894, 897-98 (6th Cir. 1992); *Dean*

Witter Reynolds, Inc. v. McCoy, 995 F.2d 649, 651 (6th Cir. 1993) (["T]he question of arbitrability under NASD § 15 is not arbitrable . . . [W]e hold only that the District Court must make [the eligibility] determination."); and most recently in *The Ohio Company v. Nemecek*, 98 F.3d 234 (6th Cir. 1996.)

A majority of the circuits are in accord that the primary power to decide arbitrability issues rests with the courts: *Cogswell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 78 F.3d 474 (10th Cir. 1996) ("[W]e join the Third, Sixth, Seventh and Eleventh Circuits in holding § 15 of the NASD Code defines the arbitrators' substantive jurisdiction and that the courts, not the arbitrators themselves, must decide whether a claim is time-barred under that provision."); *PaineWebber, Inc. v. Allen*, 45 F.3d 427 (4th Cir. 1995), *cert. denied*, 133 L. Ed. 2d 17, 116 S. Ct. 52 (1995), *affirming without opinion district court's conclusion*, 888 F. Supp. 53 (E.D. Va. 1993), that arbitrability was "undeniably an issue for judicial determination."; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen*, 62 F.3d 381, 385 (11th Cir. 1995) ("[T]he court decides whether claims are timely under section [15] of the NASD Code."); *Edward D. Jones & Co. v. Sorrells*, 957 F.2d 509, 514 (7th Cir. 1992) ("Thus, whether Section 15 bars a claim from submission to the arbitrators is for the court to decide, and it is irrelevant whether the arbitrators have already ruled on the question."); and *PaineWebber v. Hartmann*, 921 F.2d 507, 514 (3rd Cir. 1990) ("[T]he question of arbitrability is undeniably an issue for judicial determination."). The Code cannot reasonably be interpreted to conflict with Supreme Court precedent.[6]

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6. The Funds refer to a split between the circuit courts on who decides arbitrability issues. *See* petition for a writ of certiorari, p. 7. The Funds, however (1) fail to explain why this case presents compelling circumstances on an important matter justifying Supreme Court review; (2) do not cite or discuss a single circuit court decision which favors its position; (3) cannot demonstrate that an arbitral resolution of this issue would alter the ultimate

(Cont'd)

Curiously, the Funds cite with approval both *AT&T* and *Litton*. (*See* petition for a writ of certiorari, p. 7). The Funds' reliance on *AT&T* and *Litton* is mystifying in view of their assertion that the arbitrators should decide whether a party is bound to arbitrate and what issues must be arbitrated. The Funds' position is neither logical nor consistent. Regardless, the law clearly authorizes courts, and not arbitrators, to make the threshold determination of a claim's eligibility for arbitration.

B. Section 15 Is Neither In Conflict With Nor Overridden By Other Sections Of The NASD Code Of Arbitration.

The Funds insist that § 15 is in conflict with §§ 35 and 6 of the Code. The Funds contend these sections override § 15. The Sixth Circuit did not reach this issue, but the Funds' argument is without merit.

1. Section 35: Interpretation Of Code

The primary objection advanced by the Funds is based upon § 35 of the Code, which provides in pertinent part:

> The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code . . .

In *Cogswell*, 78 F.3d at 480, the Tenth Circuit appropriately observed that:

> § 35 states merely that "arbitrators shall be

(Cont'd)
outcome since the claim was filed well outside of the very generous six-year time frame imposed by § 15; and (4) incorrectly calculate the split: a majority of the circuits to decide the issue have ruled in PSI's favor.

> empowered to interpret and determine the applicability of all provisions under this Code." It says nothing specific about whether the arbitrator or the court should decide whether a claim is arbitrable under §15. Furthermore, it is well established under the generally applicable rules governing contract interpretation that specific provisions, like §15, take precedence over more general provisions, like §35. *Mutual Life Ins. Co. v. Hill*, 193 U.S. 551, 558, 48 L.Ed. 788, 24 S.Ct. 538 (1904) . . .

See also Cohen, 62 F.3d at 384; and *Sorrells*, 957 F.2d at 514.

The Funds misconstrue the plain intent and meaning of § 35. This section of the Code is intended to reserve the meritorious resolution of eligible claims to the arbitrators. Section 15 restricts those matters which are eligible for arbitral resolution by declaring jurisdictionally unworthy those claims which are stale. Section 35 cannot be reasonably read to preclude judicial determination of the arbitrability issue; such an interpretation would (1) conflict with Supreme Court precedent; (2) permit a more general Code provision to control a more specific provision; and (3) wrongly permit arbitrators to resolve the scope of their own jurisdiction in the absence of a clear and unmistakable expression of intent that the parties did not want a judicial resolution of this threshold issue.

2. Section 6: Legal Proceedings

The Funds also incorrectly argue that their filing of an arbitration claim bars PSI from seeking judicial relief. Section 6 provides:

> No party shall, during the arbitration of any matter, prosecute or commence any suit, action or proceeding against any other party touching upon any of the matters referred to arbitration pursuant to this Code.

The Funds' conduct and words are at odds. After all, the Funds initiated proceedings against PSI in the district court prior to the NASD conducting a hearing on the merits or rendering any type of award.

Section 6 has not troubled lower courts. It is well recognized that § 6 plainly means that after arbitrators have commenced a *hearing on the merits*, a party may not concurrently seek judicial relief on the substance of the dispute before the arbitrators. *See, e.g., Cogswell; Cohen.* Here, no hearing on the merits commenced; PSI has lawfully sought to preclude the hearing of a patently ineligible claim.

Finally, courts routinely hear requests for temporary injunctive relief in arbitrable disputes. Section 6 has been interpreted "to bar only parallel actions in court seeking to litigate the *substance* of the dispute in arbitration." SEC Release No. 34-36145, August 30, 1995. (Emphasis added). Section 6 in no way conflicts with § 15.

CONCLUSION

The district court properly found diversity jurisdiction. Moreover, this case raises threshold issues of arbitrability which were properly decided by the courts, not arbitrators.

For the reasons stated, the Funds' petition for a writ of certiorari should be denied.

Respectfully submitted,

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Supreme Court, U.S.
FILED
961135 JAN 2 1997
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No.

In The

Supreme Court of the United States

October Term, 1996

CITY OF DETROIT PENSION FUND and CITY OF DETROIT POLICE and FIREMAN PENSION FUND,

Petitioners,

vs.

PRUDENTIAL SECURITIES, INC.,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT FILED JULY 31, 1996

No. 95-1078

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

CITY OF DETROIT PENSION FUND; CITY OF DETROIT POLICE AND FIREMAN PENSION FUND,

Plaintiffs-Appellants,

v.

PRUDENTIAL SECURITIES INCORPORATED,

Defendant-Appellee.

ON APPEAL from the United States District Court for the Eastern District of Michigan

Decided and Filed July 31, 1996

Before: NORRIS and SUHRHEINRICH, Circuit Judges; WELLS, District Judge.*

ALAN E. NORRIS, Circuit Judge. Plaintiffs, the City of Detroit Pension Fund and the City of Detroit Police and Fireman Pension Fund (the "Funds"), appeal the judgment of the district court denying their petition to confirm an arbitration award and

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* The Honorable Lesley Brooks Wells, United States District Judge for the Northern District of Ohio, sitting by designation.

enjoining further arbitration. The Funds present two questions for review: (1) whether the district court had subject matter jurisdiction; and (2) whether the district court erred in deciding the merits of the arbitrability issue, rather than awaiting a determination by an arbitration panel. We affirm.

I. Facts

In late 1985 and early 1986, the Funds purchased from defendant Prudential Securities Incorporated ("PSI") the interests in a limited partnership costing a total of $10,000,000. While PSI and the Funds anticipated a thirty-five percent annual return on this investment, no such profit was realized. In fact, the Funds assert that they will not receive even a return of their principal when the limited partnership fully winds up its operations. On February 2, 1994, the Funds filed a Claim for Arbitration with the National Association of Securities Dealers, Inc. ("NASD"), alleging violations of (1) New York Stock Exchange Rule 405; (2) Art. III, § 2 of the NASD Rules of Fair Practice; (3) the Michigan Uniform Securities Act, Mich. Comp. Laws §§ 451.501-.817; (4) unspecified sections of the federal securities laws; and (5) the fiduciary duties imposed by the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended, 29 U.S.C. §§ 1001-1461. The Funds sought damages in excess of $11,350,000. As a member of NASD, PSI is required to arbitrate any disputes arising out of its business dealings with its customers pursuant to the NASD Code of Arbitration Procedure (the "Code").

Upon receipt of the Claim for Arbitration, NASD served PSI with a copy of the claim and informed PSI that an answer was due by April 12, 1994. PSI represents that it contacted NASD and informed the case administrator that it would be challenging in court NASD's authority to arbitrate the claims.

Appendix A

PSI asserts that the case worker informed PSI that the arbitration would be put on hold pending the resolution of any litigation. PSI did not, in fact, initiate any lawsuit.

On April 28, 1994, the Funds requested a default judgment from NASD. On May 5, 1994, having heard nothing from NASD and having received no answer to its claim from PSI, the Funds commenced this action by filing a Petition for Confirmation of Award. PSI responded by pointing out that there was no arbitration award for the district court to confirm. While the Funds assumed that the failure of PSI to file an answer with NASD by the April 12 deadline would automatically result in the entry of a default judgment, the Code plainly indicates otherwise. Section 25(b)(2)(iii) indicates that the sanction available where a party fails to file a timely answer is that the party "may, in the discretion of the arbitrators, be barred from presenting any matter, arguments or defenses at the hearing." Indeed, the Code does not appear to authorize a default judgment in any case. A party seeking arbitration is not without a remedy, though, since courts routinely issue orders compelling uncooperative parties to arbitrate.

PSI also argued that, because of § 15 of the Code, the Funds' claims were not eligible for submission to NASD as they were more than six years old. The relevant portion of § 15 provides that "[n]o dispute, claim, or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim, or controversy." PSI sought a declaratory judgment that the claims were ineligible for submission to arbitration. The Funds replied that the six-year period for bringing claims was tolled by the doctrine of fraudulent concealment, which PSI parried by arguing that § 15 is not subject to tolling.

Appendix A

On December 23, 1994, the district court concluded that it was unnecessary to decide whether § 15 is subject to tolling, because the Funds had failed to allege facts that would support a finding of fraudulent concealment. The district court then granted PSI's motion to enjoin the arbitration, to dismiss the arbitration claims, and to dismiss the petition for confirmation of the arbitration award. This timely appeal follows.

II. Subject Matter Jurisdiction

Jurisdiction was not a significant issue in the district court, and it was ignored in the parties' appellate briefs. After briefing but before oral argument, the Funds notified this court that they intended to challenge the subject matter jurisdiction of the district court. Failure to object to subject matter jurisdiction before the district court does not preclude appellate review, *Nationwide Mut. Ins. Co. v Cisneros,* 52 F.3d 1351, 1361 (6th Cir. 1995), *cert. denied,* 116 S. Ct. 973 (1996); and we must address this issue even though it is presented for the first time on appeal. *Von Dunser v. Aronoff,* 915 F.2d 1071, 1074-75 (6th Cir. 1990).

This district court treated this case as a federal question dispute with jurisdiction premised upon 28 U.S.C. § 1331 and the Federal Arbitration Act, 9 U.S.C. §§ 1-16, under which the petition to confirm was filed. In light of this court's decision in *Ford v. Hamilton Investments, Inc.,* 29 F.3d 255, 257-59 (6th Cir. 1994), however, it is plain that the Federal Arbitration Act does not give rise to federal jurisdiction. Similarly, the federal nature of the claims submitted to arbitration would not appear to be a sufficient basis for jurisdiction under 28 U.S.C. § 1331, since the rights asserted here are actually based on the contract to arbitrate rather than on the underlying substantive claims. *See In re Application of Prudential Sec. Inc.,* 795 F. Supp. 657, 658-59 (S.D.N.Y. 1992).

Appendix A

Upon receiving the Funds' letter indicating an intent to challenge jurisdiction, this court requested the parties to submit letter briefs addressing the existence of federal question jurisdiction and any other potential bases for jurisdiction. PSI indicated that the requirements of diversity jurisdiction under 28 U.S.C. § 1332 are satisfied, because (1) the Funds are Michigan corporations with their principal places of business in Michigan, (2) PSI is a Delaware corporation with its principal place of business in New York, and (3) the amount of controversy greatly exceeds $50,000. At oral argument, the Funds admitted these jurisdictional facts but argued that diversity jurisdiction did not exist because of a failure on the part of PSI to exhaust administrative remedies.

The cases relied on by the Funds do not, however, apply. *Pennsylvania Railroad Co. v. Day,* 360 U.S. 548 (1959), and *Dones v. Eastern Air Lines, Inc.,* 408 F. Supp. 1044 (D.P.R. 1975), stand for the rule that a federal statutory scheme that creates a right of action and vests in an administrative agency exclusive jurisdiction over any claims operates as an implied partial repeal over more general grants of jurisdiction such as those based on diversity of federal question. In such a situation, failure to exhaust administrative remedies generally bars judicial review. *See* 360 U.S. at 552; 408 F. Supp. at 1048. Here, there is no such administrative scheme for processing arbitration claims. *New Era Life Ass'n v. Zangbell,* 266 Mich. 371, 254 N.W. 134 (1934), tells us only that, under Michigan law, fraternal organizations may require the exhaustion of internal appeals procedures before a claimant may go to court. *See id.* at 377, 254 N.W. at 136. The case before us has nothing to do with any fraternal organization.

Assuming, arguendo, that there is no basis for federal

question jurisdiction, and given the agreement by the parties that the elements of diversity jurisdiction are satisfied, the question becomes whether this court can uphold the district court's exercise of jurisdiction on a basis other than that recognized by the district court. Where there is a challenge on appeal to the subject matter jurisdiction of the district court, this court may take notice of other bases for jurisdiction. *See Eisler v. Stritzler*, 535 F.2d 148, 152 (1st Cir. 1976) ("Although we normally would be disinclined to note, sua sponte on appeal, alternative grounds for the district court's jurisdiction . . . , there is no impediment to our doing so . . . ."). Particularly where a plaintiff invokes the jurisdiction of the federal courts, loses in the district court, and then seeks to avoid the preclusive effects of that judgment by challenging on appeal the subject matter jurisdiction of the district court, it seems to us that a court of appeals should avoid dismissing the case for want of jurisdiction if a basis for federal jurisdiction appears in the record, including the appellate briefs and arguments of the parties.

Because the parties are of diverse citizenship and the requisite minimum amount is in controversy, the district court had jurisdiction under 28 U.S.C. § 1332.

III. Determination of Arbitrability

The focus of the Funds' argument in their brief is that the district court should not have decided whether the claims against PSI were eligible for arbitration. Instead, the Funds argue, the district court should have ordered PSI to submit the arbitrability issue to an arbitration panel. Whether the district court may decide the merits of a § 15 eligibility dispute before the arbitrators have had the opportunity to address the issue is a legal question we review de novo. *See Stevens v. McGinnis, Inc.*, 82 F.3d 1353, 1356 (6th Cir. 1996).

Appendix A

This claim is controlled by *Litton Financial Printing Division v. NLRB*, 501 U.S. 190 (1991), where the Supreme Court pointed out that "[w]hether or not a company is bound to arbitrate, as well as what issues it must arbitrate, is a matter to be determined by the court, and a party cannot be forced to 'arbitrate the arbitrability question.' " *Id.* at 208 (quoting *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 651 (1986)). *See also Dean Witter Reynolds, Inc. v. McCoy*, 995 F.2d 649, 651 (6th Cir. 1993) ("[T]he question of arbitrability under NASD § 15 is not arbitrable . . . ."). While the Funds make much of PSI's supposed breach of the NASD rules in raising the arbitrability issue before the district court, it cannot be overlooked that the Funds initiated the district court proceedings by filing a petition to confirm a non-existent arbitration award premised on a non-existent default judgment. Even if the Funds had not been the ones to initiate this litigation, though, *Litton and Dean Witter* plainly demonstrate that PSI would be permitted to raise the arbitrability issue with the court without prior submission to arbitration.

The district court did not err in resolving the arbitrability issue.

IV. Susceptibility of § 15 to Tolling

The only argument the Funds make concerning the correctness of the district court's determination that the claims are not arbitrable is as follows: "[T]he entering of a plea of guilty on October 24, 1994 raises the fact question of whether [there] was active concealment of the fraud, thereby extending the eligibility period of claims to begin on that day." We need not reach the issue of whether § 15 is subject to tolling on the basis of fraudulent concealment, because the Funds did not

adequately plead fraudulent concealment before the district court. The guilty plea to which the Funds refer is irrelevant, since it involves investors and investments different from those at issue here. PSI's acknowledgment of wrongdoing with respect to transactions unrelated to the Funds or the Emited partnership in which they invested is wholly unrelated to this case.

V. Conclusion

The judgment of the district court is affirmed.

APPENDIX B — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MICHIGAN DATED DECEMBER 23, 1994

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Civil Action No.
94-CV-71767-DT

HON. BERNARD A. FRIEDMAN

CITY OF DETROIT PENSION FUND, et al.,

Plaintiffs,

vs.

PRUDENTIAL SECURITIES, INC.,

Defendant.

MEMORANDUM OPINION AND ORDER

This matter is presently before the court on the court's review of the parties' supplemental briefs addressing the issue of the tolling of the six-year eligibility period for arbitration as it relates to the allegation of fraudulent concealment. At a hearing on December 1, 1994, the court granted Defendant's motion to enjoin and dismiss arbitration claim and to dismiss petition for confirmation of award, subject to the parties' submission of briefs discussing this remaining issue, which the court now addresses.

Appendix B

Plaintiffs City of Detroit Pension Fund and City of Detroit Police and Firemen Pension Fund invested five million dollars in Prutech Project Development Partnership in October, 1985, and again in December, 1986, for a total of ten million dollars. The partnership interest was sold to Plaintiffs by Defendant Prudential Bache Securities, Inc., by its agent Harold Rossen.

Plaintiffs allege that Defendant, through Rossen, made misrepresentations to them about the annual return on their investment, the safety of their investment, sales commissions and fees, and failed to inform them of the high risk of the investment. On February 2, 1994, Plaintiffs submitted a Claim for Arbitration and a Uniform Submission Agreement, electing to arbitrate their dispute with Defendant, to the National Association of Securities Dealers (NASD), of which Defendant is a member. In their claim for Arbitration, Plaintiffs allege violations of Rule 405 of the New York Stock Exchange, Article 3, § 2 of the NASD Rules of Fair Practice, the Michigan Uniform Securities Act, M.C.L. § 451.810, and the fiduciary duty requirement of the Employee Retirement Income Securities Act (ERISA), 29 U.S.C. § 1001, *et seq.*

On April 28, 1994, Plaintiffs filed a Request for Default with the NASD, claiming that Defendant did not respond to its claim. On May 5, 1994, Plaintiffs filed a Petition for Confirmation of Award in federal court, requesting that the court confirm a judgment in the amount specified in the Claim for Arbitration, over $11 million. On June 3, 1994, Defendant filed a motion to enjoin and dismiss Plaintiffs' arbitration claim and to dismiss the petition for confirmation of award, which the court granted on December 1, 1994, subject to further review by the court of the issue of the tolling of the six-year arbitration eligibility period in relation to the allegation of fraudulent

concealment, in light of recent case law which the parties had not included in their initial briefs.

I. *Tolling the six-year eligibility period and fraudulent concealment*

> Rule 15 of the NASD Code of Arbitration Procedure states:
>
> No dispute, claim, or controversy shall be eligible for submission to arbitration under this Code *where (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim, or controversy.* This section shall not extend applicable statutes of limitations, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.

(emphasis added).

The parties dispute whether or not the six-year eligibility period is subject to tolling as a result of an allegation of fraudulent concealment. Although both the Third and Seventh Circuits have addressed this issue and have held that § 15 cannot be tolled (*see PaineWebber, Inc. v. Hofmann*, 984 F.2d 1372 (3d Cir. 1993), and *Edward G. Jones & Co. v. Sorrells*, 957 F.2d 509 (7th Cir. 1992)), there is no definitive statement on this point in either the Sixth Circuit or the Sixth Circuit district courts, which have issued conflicting rulings.

In arguing that fraudulent concealment can toll the six-year eligibility period, Plaintiffs rely on *Roney and Co. v. Kassab*,

981 F.2d 894, 900 (6th Cir. 1992) and *Dean Witter Reynolds, Inc. v. McCoy*, 995 F.2d 649, 651 (6th Cir. 1993). In *Roney*, the court did not explicitly state that fraudulent concealment exempts a claim from the six-year eligibility period. The court did, however, lay out the requirements for fraudulent concealment and then concluded that the appellees had not stated a sufficient claim for fraudulent concealment. *Roney*, 981 F.2d at 900.

The Sixth Circuit in *McCoy*, in remanding the case to the district court for a determination of which claims were eligible for arbitration, stated:

> . . . should the District Court find, applying the relevant State law, that Dean Witter or its agents succeeded in fraudulently concealing their alleged wrongs, then the claims potentially may still be pursued in arbitration. *See Roney*, 981 F.2d at 900.

McCoy, 995 F.2d at 651.

The district court, on remand, however, found that tolling of the eligibility period is not allowed based on fraudulent concealment. The court explained that the statement, *supra*, by the Sixth Circuit in *McCoy* "is dicta and is not consistent with the Sixth Circuit's holding in *Roney*." *Dean Witter Reynolds, Inc. v. McCoy*, 853 F. Supp 1023, 1029 (E.D. Tenn. 1994). The court stated that it "interprets *Roney* and *McCoy* to mean that it remains an open question in the Sixth Circuit whether Section 15 should be treated as a statute of limitations which is subject to equitable tolling on the ground of fraudulent concealment . . ." *Id.* The district court then held that "since Section 15 is an eligibility or jurisdictional requirement rather than a statute of

limitations, it is not subject to equitable tolling on the ground of fraudulent concealment." *Id.* at 1031. The court further stated:

> This Court is convinced that if the Sixth Circuit were confronted with this particular question of law, it would choose to follow the decisions of the Third and Seventh Circuits in *Hofman* and *Sorrells*, respectively. Such a result is entirely consistent with the Sixth Circuit's analysis and holding in *Roney*.

Id.

A few months later, the Eastern District of Michigan held otherwise, in *Davis v. Keyes*, No. 93-CV-73879 (E.D. Mich. August 1, 1994). In reliance on the Sixth Circuit cases of *McCoy* and *Roney*, the court held that the six-year eligibility period does operate as a statute of limitations which is subject to tolling in cases of fraudulent concealment. The court stated:

> Explicit in the court of appeal rulings and findings in *Roney* and *McCoy*, is the conclusion that the six-year eligibility period operates as a statute of repose. Implicit in the ruling is the conclusion that fraudulent concealment is a condition which tolls the six-year eligibility period. The instruction provided to the district court by the court of appeals in *McCoy* is both explicit and unambiguous. 995 F.2d at 651. If there is adequate proof of fraudulent concealment, defendants' claims more than six years old 'may still be pursued in arbitration.'

Id. at 6. Nevertheless, the court found that tolling was not warranted because defendants had not alleged facts which constitute fraudulent concealment. The court did not address the district court's decision in *McCoy* on remand, discussed *supra,* which held that tolling of the eligibility period is not allowed as a result of an allegation of fraudulent concealment.

Most recently, the Western District of Michigan addressed this same issue in *A.G. Edwards & Sons, Inc. v. Clark,* No. 1:94-CV-441 (W.D. Mich. Sept. 12, 1994). There, while the court recognized the conflict between the Sixth Circuit district courts in *McCoy* and *Keyes,* it found it unnecessary to decide between the two since the respondents' claims did not set forth facts supporting a tolling of the eligibility period.

In the instant case, it is similarly not necessary for the court to decide the tolling issue, as Plaintiffs have not plead sufficient facts to constitute a finding of fraudulent concealment. In all averments of fraud, the circumstances constituting fraud shall be stated with particularity. Fed. R. Civ. P. 9(b). The Sixth Circuit in *Roney and Co. v. Kassab,* 981 F.2d 894, 900 (6th Cir. 1992), outlined the requirements for fraudulent concealment: some affirmative fraudulent act and an additional act to perpetuate the concealment. Mere inaction or silence is not sufficient. *Id.*

As noted by Defendants, Plaintiffs did not allege fraudulent concealment in their NASD claim for arbitration. Defendant's supplemental brief, p. 6. In their response to Defendant's motion, Plaintiffs summarily claim that Defendant "fraudulently concealed the wrongs perpetrated on Plaintiffs by failing to properly inform them of the value of the limited partnerships, and in the event they did, they misstated the value of the investments, thereby bringing the claims within the eligibility

requirements for arbitration." Plaintiffs' Response to Defendant's motion, p. 6. However, Plaintiffs do not allege specific statements made or acts performed by Defendant which amount to fraudulent concealment.

Plaintiffs' supplemental brief is no more revealing. Plaintiffs explain that the First Quarter Report for the investment at issue, dated March 31, 1992, was an optimistic cover-up of the "sad state of affairs of the partnership," which were eventually revealed to Plaintiffs in a letter five months later, dated August 6, 1992. Plaintiffs' supplemental brief, pp. 1-2. The letter, written by Richard Moser, president of R & D Funding Corp., and not Defendant Prudential Securities, reveals that dividends and interest were not received from Prutech and that a market value of the partnership was unavailable. Plaintiffs' supplemental brief, Exhibit 2.

In reliance on a Wall Street Journal article, October 28, 1994, Plaintiffs state that Defendant admitted to criminal acts in the sale of limited partnerships on October 17, 1994. Plaintiffs' supplemental brief, Exhibit 4. Lastly, Plaintiffs claim that Defendant "made representations" to Plaintiffs as late as March 28, 1991, on the investments at issue, as evidenced by the Journal of Proceeding of the Board of Trustees of the Policemen & Firemen Retirement System. Plaintiffs' supplemental brief, Exhibit 5.

Plaintiffs' allegations are insufficient to constitute an affirmative fraudulent act and an additional act to perpetuate the concealment, as required by the Sixth Circuit in *Roney, supra.* First, both the First Quarter Report and the August letter were written by Prutech, the partnership in which Plaintiffs invested, not Defendant Prudential Securities. In any event, the report is

not necessarily "optimistic," as Plaintiffs contend. It revealed that the partnership's total assets were only a little more than $2 million dollars, while Plaintiffs had invested $10 million dollars in the partnership years earlier. The report clearly reveals, rather than conceals, that the partnership had lost a significant amount of money.

In addition, the report admonishes that the "operating results for the three months ended March 31, 1992 should not be considered indicative of the results expected for a full year." First Quarter Report, March 31, 1992, p. 8. The report states that the partnership will terminate on December 10, 1992, unless extended by a vote of the limited partners and warns that should the partnership terminate on that date, "it is uncertain whether investments in equity securities will be realized at the cost at which they are recorded." *Id.* Thus, the report appears to warn Plaintiffs that their investment is at risk, thereby frustrating Plaintiffs' claim of fraudulent concealment.

Second, that Defendant acknowledged criminal wrongdoing in another case by misleading investors on the risks and returns of partnerships, which invested in oil and gas properties, as reported in the Wall Street Journal, does not necessarily have a bearing on the partnership at issue. There is no evidence that Defendant committed the same illegal actions in the instant case as in the case discussed in the Wall Street Journal article.

Third, that Defendant "made representations" to Plaintiffs at board meetings is insufficient to constitute fraudulent concealment. Plaintiffs do not state what these "representations" were. The minutes of the meetings (Plaintiffs' supplemental brief, Exhibit 5) merely state that Hal Rossen and either an associate or Dick Moser appeared before the Board and

discussed Prutech on various occasions. The content of their statements are not provided.

Lastly, Defendant explains that by signing subscription documents at the time of purchase of their investment, Plaintiffs attested to their knowledge and awareness of the risks involved in their investment. Defendant's supplemental brief, p. 5. There is no evidence that Defendant concealed the risks of the investment.

The court additionally notes that Plaintiffs could likely have discovered Defendant's alleged misrepresentations, or concealment, within one year of the purchase of their investment, and in each subsequent year, when they did not receive the annual return on their investment, allegedly promised by Defendant.

II. *Fiduciary duty*

Plaintiffs contend that an affirmative duty to disclose arises where a fiduciary duty exists and that this is an exception to the rule that fraudulent concealment must be manifested by an affirmative act in order to postpone the running of the six-year eligibility period. *Brownell v. Garber,* 199 Mich. App. 519 (1993). Plaintiffs argue that such a fiduciary relationship between the parties existed here. Defendants dispute this.

Plaintiffs rely on *Zimmerman v. Merrill Lynch, Pierce, Fenner & Smith,* 151 Mich. App. 566 (1986), which held that a fiduciary relationship exists between a securities broker and the owners of its accounts. In *Zimmerman,* however, unlike the case at bar, the parties did not dispute that a fiduciary relationship existed. *Id.* at 572.

Appendix B

It appears that a fiduciary relationship did not exist between the parties. Plaintiffs' account with Defendant appears to be non-discretionary, as Plaintiffs, a large, presumably sophisticated pension fund, made only two transactions, both of which were investments in the same partnership. A broker handling a non-discretionary account is not the fiduciary of his customer. *Leib v. Merrill Lynch, Pierce, Fenner & Smith,* 461 F. Supp. 951, 953 (E.D. Mich. 1978). Consequently, as Defendant did not have more than a limited duty toward Plaintiffs, the fiduciary duty exception to the requirement that an affirmative act of fraud be shown to toll the eligibility period is likely not applicable here.

For the foregoing reasons, it appears that Plaintiffs have not sufficiently plead fraudulent concealment. As a result, the court need not address whether or not an allegation of fraudulent concealment tolls the six-year eligibility period. Accordingly.

IT IS ORDERED that Defendant's motion to enjoin and dismiss arbitration claim and to dismiss petition for confirmation of award is granted.

s/ Bernard A. Friedman
BERNARD A. FRIEDMAN
UNITED STATES DISRICT JUDGE

Dated: Dec. 23, 1994
Detroit, Michigan